bid was determined to have met the RFP's basic requirements and comparatively evaluated by a four person team vis-à-vis the ENA proposal as summarized on the following composite Proposal Score Summary Matrix (ISIS 2000 Objection, Attachment D). As shown by each scorer's evaluation, the evaluation of Technical Approach varied with three scorers (Waldie, Hoover and Kompare) placing ISIS 2000 much closer than one scorer (Shrago).

Proposal Score Summary Matrix
(Average of Four Scorers)

	ENA	ISIS 2000
Qualifications	9	8.5
Experience	13	12.125
Technical Approach	35.375	26
Cost	30	20.837
Total Points	87.375	67.462

Moreover, as shown by the Department's test evaluation of Throughput capabilities (the best objective measure of Internet Access capabilities), attached as Attachment V, both ISIS 2000 and ENA were found to have met the RFP's requirements.

We readily concede that there are differences between ENA and ISIS 2000 in their basic approach to meeting the

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6.2.4 The Proposal Evaluation Team shall evaluate proposals determined to have met proposal requirements based upon the criteria set forth in this RFP. Each evaluator shall score each proposal. The evaluation scoring shall use the pre-established evaluation criteria and weights set out in this RFP. Each evaluator shall use only whole numbers for scoring proposals. [citation omitted]

Department's Internet access needs. Indeed, it is because of the quite different approach followed by ENA that its proposal is so violative of fundamental USF funding requirements. However, even if it is assumed that the basic difference in approach results in a marginally more superior degree of service to the Department (which ISIS 2000 strongly believes is not the case), such a marginal difference by any objective standard does not justify the over $23 million additional pre-discount cost of the ENA proposal.

The Department contends that ENA would have received the bid award without considering cost considerations (Department Opposition, p. 11, fn. 8). This might be true under the above scoring if cost were just eliminated as a scoring factor. However, if the cost factor were scored properly on the basis of pre-discount costs, there is no logical way that a $23,000,000 cost difference in ISIS 2000's favor could be found to be outweighed by the marginal differences in Technical Approach represented by the above scores. If the Department was spending State funds for such perceived incremental differences, we doubt the decision would have been the same.

Moreover, to the extent the Department desired the claimed marginal benefits, this could have been lawfully achieved by the Department paying its correct pro-rata share of the overall pre-discount project cost and/or treating the additional features as non-reimbursable expenses, as

required by USF funding rules. Unfortunately, however, the unusual structure of the RFP provided no reason or incentive for the Department even to consider overall pre-discount project cost as a potentially relevant countervailing factor to its desired overall scope of services. Rather, by placing an arbitrary ceiling on the amount to be expended by the Department and encouraging prospective bidders to maximize the amount of USF funding to be obtained, the RFP did precisely the opposite. The Department is quite candid on this score, contending at one point, for example, that the ENA approach to Internet access is preferable because it is "more robust, more reliable, and more expensive." (Department Objection, Attachment C, p. 6).

The Department contends that there are no USF limits or "specifications on what an Internet Service Provider can offer with the exception of content and the expectation that cost guidelines are met. . ." which the Department describes as "the most cost-effective means of providing Internet access" (Department Objection, Attachment B, Shrago April 2, 1998 memorandum, p. 3). Under this standard,

> "The Department of Education fully expects that the costs pertaining to the services of the ENA proposal are well within the guidelines of the FCC definition of Internet access and will be approved as cost-effective." (Id.)

The ENA contract may be cost-effective from the Department's standpoint because it spends over $23,000,000 more in USF funds without costing the Department any more

money. As the Department summarized the basic financial benefit to it from the ENA proposal:

> "The State will pay either proposer the same amount of dollars. ENA demonstrated its understanding of the State's RFP requirements and maximized the opportunity for obtaining FCC E-rate funds. . ." (Ibid. at p. 4).

This, however, is not the fundamental cost control mechanism required by Section 54.511 of the Commission's rules. Quite to the contrary, the fundamental intent of the competitive bidding requirement was to obtain the best available pre-discount price for the desired services for the benefit of both the local authority and the federal USF fund. By achieving just the opposite result, the RFP turned all logic on its head in direct contravention of Section 54.511 competitive bidding requirements.

Conclusion

The implicit suggestion that ISIS 2000 is merely attempting to use the FCC's processes to reverse a local bid award within the appropriate discretion of the Department is not true. Obviously, to lose a substantial bid award, not because of a fair competition but because of the manner in which the opposition played with USF funding rules to win the bid, is not a pleasing situation, which ISIS 2000 is seeking to reverse at the local level. The outcome of this FCC proceeding, however, most certainly will not result in any automatic win for ISIS 2000 on the local level.

In the event the ENA contract is found to be unqualified for USF funding, local procedures accord the Department broad discretion to act, including the option to re-bid the contract. In that event, ISIS 2000 stands ready to compete on a fair and equal playing field. Furthermore, as the current operator of the ConnecTEN network, ISIS 2000 will agree to any reasonable temporary extension of its existing management contract to permit the continuation of existing services pending such re-bidding. All we seek is the opportunity to compete by the same USF funding rules.

Moreover, the questions raised herein are not just limited to the present Tennessee ENA contact. ISIS 2000 is currently or soon will compete for other contracts under the USF Schools and Libraries Program which have the clear potential for raising similar issues. If a would-be service provider is able to leverage up the available USF funding through artificially constructed "wash" purchases of existing network equipment (particularly from an entity qualifying for a high discount) under the guise of providing Internet access, this completely changes the rules of the game as understood by ISIS 2000 and most other responsible service providers participating in this program.

For these reasons, ISIS 2000 requests that the Commission expeditiously issue the requested declaratory ruling finding the ENA contract ineligible for USF funding and commencing a further proceeding to disqualify ENA and

its principals from further participation in the USF Schools and Libraries Program.

Respectfully Submitted,

INTEGRATED SYSTEMS AND
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April 27, 1998

DECLARATION

Under penalty of perjury, Jeff Hustad hereby states as follows:

1. I am Chief Technical Officer of ISIS 2000, Inc.

2. I have read the foregoing "Reply to Oppositions," dated April 27, 1998, which I understand is to be filed with the Federal Communications Commission.

3. The facts contained therein are true and correct.

Jeff Hustad

April 27, 1998

In Re: Federal-Joint State Board on Universal Service

CC Docket No. 96-45

ECONOMIC ANALYSIS OF EDUCATION NETWORKS OF AMERICA CONTRACT

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April 27, 1998

Qualifications

Rampart Associates, Inc. is a Denver based brokerage, consulting and investment banking firm focused exclusively on the ISP and Telecommunications markets. As such we are familiar with the economics of investing in, developing, buying and selling Internet and other Telecommunications networks.

Paul Stapleton is Senior Vice President at Rampart Associates, Inc. He is also the financial columnist for *Boardwatch Magazine*, the leading trade magazine for the ISP industry and Editor of *I$P Report, The Financial Newsletter for Internet Service Providers. I$P Report* is the newsletter of record for financial activity such as mergers, acquisitions, valuation and capitalization, in the ISP and CLEC industry.

Prior to joining Rampart, he operated Stapleton & Associates an Internet focused financial consulting firm, from 1993-1997. Clients have included EarthLink Network, Inc., Excite Inc., AMS, Infobeat Inc., MCI, Microsoft, News Corporation, Ziff-Davis, Coopers & Lybrand, Dvorak Development, Opus Capital, Cyberspace Development and InfoNow Corp. He has negotiated and structured over 100 strategic Internet business relationships.

Mr. Stapleton's early career experience is in banking and publishing. He has worked for Prodigy Services Company as Manager of Business Affairs (1991-93); NewsBank (1990-91), Inc. an electronic publisher and for several New York money center banks.

He has an MBA from Columbia Business School, a BSFS from Georgetown University, School of Foreign Service and an IBD from Nijenrode, The Netherlands School of Business.

Overview

Rampart Associates, Inc. has been requested to provide an analysis, from a financial point of view, of the two proposals provided to the Tennessee State Department of Education ("Department") by Integrated Systems and Internet Solutions, Inc. ("ISIS 2000") and Education Networks of America, LLC. ("ENA") respectively.

By assigning an unsubstantiated value of $7.5 million to ConnecTEN and giving it to ENA in exchange for no compensation, the State and ENA have constructed a transaction by which the USF would provide an additional $16 million to the Tennessee Internet project, while Tennessee would receive essentially the same, if not inferior, Internet access compared to the alternative proposal.

At the same time ENA shareholders would have 100% of their business start up capital supplied by the USF while maintaining 100% ownership of an Internet data network that could be worth $160 million within three years.

In the course of performing this economic analysis, we have:

1. Reviewed the ISIS 2000 Objection to Tennessee Department of Education Form 471 and ENA Contract.
2. Reviewed the ISIS 2000 Supplement Objection to Application and Request for Expedited Declaratory Ruling.
3. Reviewed the Opposition of Education Networks of America.
4. Reviewed the Opposition of the Tennessee State Department of Education.

5. Reviewed the Contract Between Tennessee Department of Education and ENA.
6. Reviewed the First Amendment to Contract Between Tennessee Department of Education and ENA.
7. Reviewed the Tennessee Department of Education Request for Proposals..
8. Reviewed the ENA Cost Proposal.
9. Reviewed the ENA General Proposal.
10. Reviewed the ENA Cost Proposal – Breakdown: First 6 months of Contract.
11. Reviewed Miscellaneous Q&A Documents re ENA Proposal.
12. Reviewed ISIS 2000 Cost Proposal.
13. Reviewed ISIS 2000 General Proposal.
14. Interviewed Mr. Henry Werchan of ISIS 2000.
15. Conducted such other studies, analysis, inquiries and investigations, as we deemed appropriate.

In the course of this review, we have relied upon and assumed the accuracy and completeness of the financial and other information summarized above and the representations related thereto. We have not assumed any responsibility for the information or estimates provided to us. In arriving at our opinion we have not performed or obtained an independent appraisal of the assets of the existing network, or the network envisioned under either proposal. Our opinion is necessarily based on economic, market and other conditions, and the information made available to us, as of the date hereof.

Background

The Tennessee Department of Education requested bids to improve the quality of Internet access provided to 1,600 schools in Tennessee.

Internet access is currently provided through the State Department of Education owned network, ConnecTEN. ConnecTEN, is an ISDN based network connecting the 1,600 schools in Tennessee to 95 central county locations which in turn, connect to the Internet cloud.

A condition to the State of Tennessee's RFP required proposals to continue to use ConnecTEN. Specifically the Department required the new network connect to the Internet cloud through the 95 state owned access points, one in each county of Tennessee.

ISIS 2000 and ENA both submitted proposals. Tennessee chose the ENA proposal.

Major Financial Differences Between the Proposals

The major differences between the two proposals are:

- Cost and
- Ownership.

The ISIS 2000 proposal offers to upgrade ConnecTEN to provide an appropriate level of service to 1,600 Tennessee schools for a price approximating $51.1 million over the life of the contract (3.5 years). The State of Tennessee will own the network.

The ENA proposal also offers to upgrade the upgrade ConnecTEN to provide an appropriate level of service to 1,600 Tennessee schools for a price approximating $74.4 million over the life of the contract (3.5 years). ENA will own the new network

Although not network engineers, as financial advisors, we would be more comfortable financing the ISIS proposal network design. Under the ENA proposal we would anticipate substantial network blockage at the 95 county sites given the number of schools required to connect to each of these sites (approximately 19 per site). ISIS 2000 offers a solution in which the larger schools by pass these sites and move immediately to the Internet cloud. (We discuss the economics of the proposed network topology's in detail later).

However, keeping our focus on the primary financial differences between the two proposals, the chart below summarizes the major differences between the two proposals.

	ISIS 2000 Proposal	**ENA Proposal**
Ownership	Department	ENA
Cost to Department	$17.9	$17.8
ConnecTEN	$0.3	$7.5
Cost to FCC	$33.2	$49.1
Total Costs	**$51.1**	**$74.4**

Under the ENA proposal:

- ENA gets ownership of a network asset with substantial future value (which we discuss later).

- The FCC pays an $49.1 million, to pay for that asset.
- The Department experiences no cash difference.
- The Department "sells" its network to ENA in exchange for nothing (which we discuss later).

Under the ISIS 2000 proposal:

- Tennessee gets ownership of a network asset with substantial future value (which we discuss later).
- The FCC pays $16 million less than under the ENA proposal.
- The Department experiences no cash difference.
- The Department "owns" a network that is serviced by ISIS 2000.

The Cost Difference

We have "ball parked" from a bottoms-up analysis what Internet access for 1600 schools in the Southeast United States might cost.

We assume 1600 schools connect to 95 county sites which in turn connect to the Internet cloud.

We assume half the schools (800) connect via dual ISDN (128kps) to the 95 county sites, while the other half (800) connect via a fractional T-1 (up to 1.5mps) that can be opened or throttled as demand is required. These assumptions mirror the network structure suggested by ENA in their proposal.

Usage based dual ISDN from Bellsouth costs between $93.50 and $117.500 per site per month in Tennessee. (see web site http://www.cnet.com/Content/Reviews/Compare/Isdn2/ss05a.bs.html).

We understand the Department has preferential pricing at $120.00 per month regardless of usage.

Internet access providers such a EarthLink and Microsoft (two quality national providers) charge between $60.00 and $100.00 per month for dual 256kps ISDN access (see web site http://www.cnet.com/Content/Reviews/Compare/Isdn2/ss05b.html). This amount is above the Bellsouth line charges and goes to the ISP for Internet management and services.

This would imply dual ISDN access for 800 schools over 3.5 years could be secured for approximately $7.4 million:

Dual ISDN Channel: 800 schools x $120.00/mos. x 42 mos. = $4.0 million

Internet Access: 800 schools x $100.00/mos. x 42 mos. = $3.4 million

The cost of fractional to full T-1 accesses for the other 800 schools can be calculated similarly.

Fractional T-1 channel from providers such as Bellsouth and Intermedia (a well-established southeast CLEC) can be purchased in bulk for approximately $550 per circuit per month. Internet access on top of the channel can be purchased for another $500 – 750/mos. Frequently, at this service level, the same network provider offers both the local loop and guaranteed bandwidth access.

Using an approximate total combined cost of $1,150/mos. we arrive at $38.6 million based on: 800 schools x $1,150/mos. x 42 mos. = $38.6 million.

Based on our assumptions above, the total costs for dual ISDN and T-1 Internet access at all schools (based on ENA's proposal) would be $46.0 million. The ENA bid was $74.4 million or $66.9 million in "hard dollars" after subtracting the $7.5 million assigned to ConnecTEN.

It is also worth noting that by marking up the above estimated Internet access costs of $46.0 million by 17.5% (a reasonable network service managers mark-up is between 15-20%) we arrive at $54.0 million. This number closely resembles the ISIS 2000 proposal of $51.1 million.

The Value of Network Ownership

The Department's stated concern about the "disadvantages" of network ownership is misdirected. Ownership does not equal management or service responsibility. Mechanics exist to service the cars we own. Portfolio managers exist to manage the financial assets we own. And network managers exist to manage the networks some of us own.

However owners are entitled to the full economic value produced by the assets they own. I doubt the Department would ever consider handing over its pension fund assets in exchange for no definable value, or hand over the title of their car to some passer by.

Who owns the network to be built determines who has the right to potentially millions of dollars of network "value".

The difference between the two proposals over the 3.5 year contract is $23.3 million dollars. This $23.3 million is broken down between $15.8 million in "hard dollars" contributed by the USF, and $7.5 million in "soft dollars" contributed by the Department in the form of an asset, namely the ConnecTEN network.

Consequently we reviewed the assigned value of $7.5 million given to the ConnecTEN network.

The Value of the Existing ConnecTEN Network.

ConnecTEN is a statewide ISDN network connecting 1,600 Tennessee schools to the Internet cloud through 95 sites, one per county in Tennessee. Its sole "customer" is the Department and it generates costs to the Department of $5 million per year to operate.

The proposed ENA transaction assigns a value of $7.5 million to the existing ConnecTEN network. ISIS 2000 assigns a "salvage value" of $295,400 to the existing ConnecTEN network based on a value provided by Cisco Systems, Inc. a leading Internet equipment vendor.

We have four observations about the value of $7.5 million that ENA assigns to ConnecTEN:

- The ENA proposal does not explain the economic rational for assigning its $7.5 million valuation to ConnecTEN.
- The ENA proposal does not compensate the State of Tennessee for "selling" the ConecTEN asset to ENA.
- The only tangible economic result of assigning ConnecTEN a value of $7.5 million is to increase the amount of money the Universal Service Fund must contribute to the project by $16 million.
- The additional $16 million in Universal Service Funds is used to build a statewide data network owned by ENA shareholders with substantial (possibly $160 million) future market value.

No Economic Rational for Assigning a Value of $7.5 million.

Nowhere in the documents provided by ENA were we able to find the methodology used to determine the value of $7.5 million assigned to ConnecTEN.

Typical methodologies such as discounted present value of cash flow, asset valuation and pay back period were not applied.

Our use of the methodologies mentioned in the prior paragraph would not result in assigning ConnecTEN a value of $7.5 million.

If a third party assumed management of the existing Internet service provided under ConnecTEN they could assume an annual revenue stream from the Department of $5 million.

If they managed their business like other network management firms they would experience profit margins ranging from 10% to 20% of revenue. Therefore theoretically management of the ConnecTEN contract would result in profit of $750,000 per year. This annual profit potential, which given the pace of technological change probably has a short life span, would not warrant an arms length purchase price of $7.5 million.

No compensation to the State of Tennessee for "selling" the ConecTEN asset to ENA

Nowhere in the documents provided by ENA or the Department were we able to find the compensation the State of Tennessee will receive for transferring the ConnecTEN asset to ENA.

Theoretically in an arms length transaction we would expect to see a payment either in the form of cash, stock, a note or reduced expenses in a service agreement. We

found no indication Department will receive compensation in any form. The proposal speaks of the Department receiving a "credit". However, the Department continues to pay $5 million per year in "hard dollars" for the same services they were receiving prior to "selling" ConnecTEN. Additionally, they receive no stock in ENA, nor any note to evidence even a loan, in exchange for contributing an asset to its business.

The Only Economic Impact of ConnecTEN's ENA Assigned Value is Increase Federal Government Spending.

Assigning a value of $7.5 million to the ConnecTEN asset allows ENA to claim Tennessee is making a $8.5 million contribution in the first six months ($1 million in hard dollars and $7.5 million in network assets). A $8.5 million Tennessee contribution allows ENA to claim matching funds of an additional $16 million from the Universal Service Fund in the first six months of the proposal.

Note: We are aware of the amendment to the ENA – Department contract that modifies this payment schedule. For purposes of economic analysis, sliding a few million into the second, or even third, six-month tranche is immaterial.

The real economic materiality of receiving an additional (and arguably unnecessary) $16 million from the USF in the early stage of the proposal is, ENA has received a de facto capital investment from USF to build a network that it will own, control and realize the economic value thereof. In exchange for no capital contribution from it shareholders.

The Capital Investment

Post transaction, ENA will own a network asset. We find it insightful to discuss the capital invested to start ENA.

We have four observations about the capital invested into ENA.

- ENA shareholders that will own 100% of ENA have contributed no capital to ENA.
- The FCC under its Universal Service Fund will contribute $49.0 million and own no part of ENA.
- Tennessee will contribute its ConnecTEN asset and own no part of ENA.
- Capital invested by the USF will create a network with sufficient capacity and capability to service customers beyond the 1,600 Tennessee schools.

The USF is financing the entire start-up costs of ENA. Shareholders are contributing no capital to the start up. In fact from a review of ENA's 1997 audited financials, we determine ENA shareholders have contributed less than $10,000 in capital to ENA.

Meanwhile, upon initiating the Tennessee school project, ENA will receive $16 million from the USF. This hard dollar contribution can be viewed as start up capital. It will be used to invest in equipment and infrastructure ENA will own in perpetuity to provide statewide Internet services to any customer.

Long term Market Effect of the Proposed Capital Infusion

A. The long term market effect of introducing a competitor into the marketplace that did not have to use its own capital,

B. has been given the opportunity to amortize its entire property, plant and equipment investment over one project

is to create a competitor who can,

- charge below market pricing for the life of the network,
- charge market pricing to produce far more substantial profits from network operations,
- or combinations between these two boundaries.

Subsequently, ENA will be able to bid lower on other Internet access projects in the state of Tennessee than companies using capital contributed by arms length investors requiring a proper risk-reward return.

To compound that, since ENA has been able to amortize the cost of its network build over one project, rather than the many that would be required in a free market situation, ENA will be able to bid lower than competitors for Internet access projects in the state of Tennessee. In a free market environment the cost of using the numerous routers and telecomm connections would be factored into a part of each project.

Market Value for the Constructed Network

If the new network is legally permitted to service customers other than the Tennessee school system and has the capacity to do so, it is possible to place a market value on the network. A market value is that value which another Telecommunications provider would be willing to spend in an arms length transaction to acquire the network.

After three years, there would exist a statewide commercially viable network providing annual revenues of at least $20 million in 1999, $14.4 million in 2000, and $14.9

million in 2001. These minimal revenues reflect only the Department's required spending under the contract and do not include other revenues that may be generated through the sale of services to other parties.

The network suggested by ENA will have additional capacity and incremental capacity can be added as needed.

Internet access is forecasted to grow at 30-80% per year for the next five years. Given the size of the State of Tennessee's population and economic activity one could conservatively forecast that ENA could, with reasonable effort, produce a revenue stream of $20 million per year for each of the next three years.

In the current environment, Internet based data networks are valued primarily on their revenue. Statewide networks, booking revenues of $20 million per year, can sell or trade for anywhere between 3.0x and 8.0x revenue.

Smaller, private equity deals are being done for lower price-to-revenue multiples (hovering between 1.5x and 3.5x). Larger, public market deals are being done for higher multiples (anywhere north of 5.0x). There have been over 120 transactions tracked by *I$P Report* during this period. In the chart below are a sample of typical data network transactions from the last 18 months.

Company	**Geography**	**Annualized Revenues**	**Purchase Price**	**Price-to-Revenue multiple**
Digex	National	$30.0 million	$150 million	5.0x
Supernet	State – Colorado	$6.5 million	$20 million	3.0x
Ultranet	State – Massachusetts	$7.0	$27.0 million	3.9x
Exodus Communications	National	$18.3 million	$327.0 million at IPO	16.7x

Subsequently, the value a statewide data network consistently generating $20 million in revenue could be between $60.0 million and $160.0 million.

ENA shareholders may potentially own a network asset of $160 million in exchange for committing none of their own capital.

This is the kind of risk vs. reward opportunity sophisticated Venture Capital firms have a difficult time finding or constructing in the free market.

The Value Under Department Ownership

Alternatively, under the ISIS 2000 contract the Department would own the network. We also assume the Department would remain the sole customer generating $14.9 million in network based revenue in the year 2001. (Although an agreement whereby ISIS 2000 sells network service to other customers on behalf of the Department in exchange for additional considerations might have merit).

Given the estimated $40 million capital investment allocated under the ISIS 2000 proposal and the guaranteed $14.9 million Department fees, one could assume the new network asset could be valued at $45 million (3.0x sales) in the year 2001.

The Financial Condition of ISIS 2000 and ENA

We have reviewed the financial condition of ISIS 2000 and ENA.

In short we found the State's comments that ENA had a superior Financial Condition (and its misreading of the audited ENA financial statements) to exhibit an

extreme ignorance of how to measure a company's financial condition, namely its operating performance, access to capital and liquidity to service debt.

As a wholly owned subsidiary of an international, publicly traded conglomerate, ISIS 2000 has the ability to effectively raise debt and equity and runs a series of operating units exhibiting proper operating performance. The fact that ISIS 2000 booked a loss of $1.3 million in 1997 is of no consequence. ISIS 2000 can complete the Tennessee bid with no strain on financial resources.

On the other extreme ENA's audited 1997 financial statements indicate ENA has a cash position, recorded at $29,521 at December 31, 1997. ENA had revenue of $145,000 in 1997 from which it earned $48,006.

ENA's book value of $1.5 million, which seemed to impress the State, is "fake". It does not represent a cash or asset contribution to the business. It's off-setting entry on the asset side of the balance sheet is a note receivable of $1.5 million contributed by the shareholders. In short, the shareholders have put "air" into both sides of the balance sheet.

ENA can barely be considered a going concern and has no financial fall back position if the Tennessee proposal experiences resource overruns.